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# THE PROBABLE LEGAL CONSEQUENCES OF INSERTING PRICE-INDEX CLAUSES IN LONG-TERM CORPORATE OBLIGATIONS

By GORDON E. McCLINTOCK\*

**I**NFLATION has been described as a general abundance of available cash, enhancing prices continually over a period of time.<sup>1</sup> The United States has been engulfed in a continuing spiral of such inflation since the onset of World War II.<sup>2</sup> It is general knowledge that inflation bears most heavily on those with fixed incomes. The fixed income group includes annuitants, pensioners, wage earners, and those receiving income from long-term obligations such as corporate and municipal bonds or long-term promissory notes upon which interest is payable over a period of years with the principal being repayable in installments or at maturity in the same sum as was originally invested.

It is the purpose of this comment to explore the probable legal consequences of inserting price-index clauses<sup>3</sup> in corporate bonds and long-term promissory notes as a method of protecting investors buying such fixed income and principal obligations from depreciation in the value of money. Basically, such a clause would provide that the principal obligation increase at a rate commensurate with the increase in a stipulated price-index during the term of the obligation, with the interest due being computed on the increased value of the obligation at a fixed reference date during each interest period.

Some fixed income groups are already protected by such clauses.

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\* Member, Third Year Class.

<sup>1</sup> NUSSEBAUM, *MONEY IN THE LAW NATIONAL AND INTERNATIONAL* 192 (rev. ed. 1950).

<sup>2</sup> In 1940, the money stock of the United States, in millions of dollars, was 28,458, of which 7,848 was in circulation. By 1965 the money stock had increased to 59,659 and circulating currency to 42,056. U.S. DEP'T OF COMMERCE, BUREAU OF CENSUS, *STATISTICAL ABSTRACT OF THE UNITED STATES* 447 (1966). The purchasing power of the dollar, with the 1957-1959 period equalling a base of \$1.00, has decreased from \$2.048 in 1940 to \$ .910 in 1965 as measured by consumer commodities; and from \$2.326 to \$ .976 during the same period as measured by wholesale commodities. *Id.* at 351. Similarly, the Bureau of Labor Statistics Consumer Price Index (CPI) which measures changes in the cost of items important to urban wage earners and clerical workers, increased from an index of 48.4 in 1939, to 112.0 in March, 1966. *Id.* at 356. A similar increase has occurred in the Wholesale Price Index compiled by the same agency during the same period. *Id.* at 351.

<sup>3</sup> Price-index clauses are alternatively denominated as "escalator clauses," "sliding-scale clauses," and "inflation provisions."

Wage contracts often use one of several forms<sup>4</sup> of escalator provisions in order to protect the employee against cost-of-living increases.<sup>5</sup> Some pension plans also employ such a provision.<sup>6</sup> Other less frequent uses of price-index clauses are in insurance<sup>7</sup> and annuity contracts, alimony and property settlement agreements, royalty agreements, welfare plans and long-term leases.<sup>8</sup> Some savings and loan associations employ a form of escalator clause which allows an increase in the interest rate without affecting the amount of the principal obligation.<sup>9</sup>

Despite juridical adherence to the nominal value theory of money,<sup>10</sup> there has been an increased public awareness of index

<sup>4</sup> *Adjusting Wages to Living Costs Under Contracts*, 5 L.R.R.M. 1032-33 (1940). Wage agreements may provide for the reopening of negotiations upon the occurrence of a stipulated increase in a particular index, or occasionally for automatic increases commensurate with the change in the cost-of-living. *Ibid.* Standard cost-of-living wage adjustment clauses appear in CCH, *UNION CONTRACT CLAUSES* ¶¶ 51309-13 (1954).

<sup>5</sup> Short discussions of the use of such clauses in labor contracts appear in: Bachman, *Cost-of-Living Escalator Clauses—Here and Abroad*, 10 LAB. L.J. 615 (1959); Johnson, *Are Cost-of-Living Escalator Clauses Inflationary?*, 11 LAB. L.J. 891 (1960); *Two-Way Escalator Clause in Oil Contract*, 19 L.R.R.M. 33 (1946); *Living-Cost Data for Bargaining*, 17 L.R.R.M. 2517 (1946); *Study of Cost-of-Living Clauses*, 10 L.R.R.M. 1213 (1942).

<sup>6</sup> 1 P-H 1966 PENSION AND PROFIT SHARING ¶ 2161, at 2121-23 (1965). For a model cost-of-living provision for a pension plan, see *id.* ¶ 30,216 (1958).

<sup>7</sup> The use of such clauses is impractical in insurance contracts, banking and public utilities because the fixed corporate income is not variable with the corresponding obligation to pay as required by an index clause. Call, *Money and the Sliding Scale Clause in Contracts*, 24 MO. L. REV. 44, 49 (1959); Dawson & Coultrap, *Contracting by Reference to Price Indices*, 33 MICH. L. REV. 685, 702 (1935).

<sup>8</sup> See Dach, *Validity of Price-Index Clauses Under the Gold Coin Joint Resolution*, 13 GEO. WASH. L. REV. 328 (1945); CCH 1966 LAB. L. REP. (3 Lab. Rels.) ¶¶ 7760.10, 7770.01.

<sup>9</sup> Newsweek, Oct. 17, 1966, p. 80.

Prudential Savings and Loan Association uses a promissory note which provides that "on or after six months from date, on three months written notice to the obligor, the holder may increase the above interest rate by a maximum of  $\frac{1}{2}$  of 1% per annum by which Prudential has increased the interest rate payable to its certificate holders on investment certificate accounts over the now existing rate." Letter From Robert J. Elliott, Prudential Savings and Loan Association, San Gabriel, California, to Gordon E. McClintock, Dec. 13, 1966, with copy of above note included.

<sup>10</sup> NUSSBAUM, *op. cit. supra* note 1, at 28, 30, 171-74. In United States courts the nominal value theory of money dominates over other theories of money. The nominalistic principal means that a monetary obligation involves the payment of so many chattels which are legal tender at the time of payment and which, if added together according to the nominal value indicated thereon, produce a sum equal to the amount of the debt regardless of both their intrinsic and functional value. MANN, *THE LEGAL ASPECT OF MONEY* 69 (1953). The term intrinsic value refers to the actual value of the token's ingredients, or the actual value of what the token may be exchanged for in terms of silver or gold. The functional value refers to the money's ability to purchase commodities on some market. *Ibid.*

numbers in the past sixty to seventy years.<sup>11</sup> An index number is a measure of the purchasing power of money;<sup>12</sup> it represents the average percentage change in the prices of a number of representative commodities from one point of time to another.<sup>13</sup> If the parties to a contract for the payment of money wish to protect themselves against changes in monetary value they often contract in reference to such an index,<sup>14</sup> or use some other means of protecting against price change.<sup>15</sup> The index chosen for such a clause should correspond to the particular needs of the parties.<sup>16</sup> Thus, whereas an employee or annuitant will be primarily interested in preserving the purchasing power of his income in the retail market, the employer or corporate borrower will be more interested in a measure reflecting changes in the price of wholesale commodities. Certain other technical requirements in the choice of an index which should be considered in drafting such a clause are amply discussed in another article.<sup>17</sup>

Price-index clauses in corporate obligations are not entirely unknown. The form for such an instrument was first suggested in an experiment undertaken by Professor Irving Fisher in 1925,<sup>18</sup> and a

<sup>11</sup> NUSSBAUM, *op. cit. supra* note 1, at 28.

<sup>12</sup> *Ibid.*

<sup>13</sup> FISHER, *THE MONEY ILLUSION* 19 (1928); see CCH 1966 LAB. L. REP. (3 Lab. Rels.) ¶ 7760.

<sup>14</sup> The use of such clauses in bonds and promissory notes, however, would appear to be minimal despite statements to the contrary by some authors who do not give particulars. FISHER, *STABLE MONEY* 388 (1934) remarks in reference to the Rand Kardex bond, which is discussed in the text *infra*, that a "few analagous types have been used by other commercial companies." CCH 1966 LAB. L. REP. (3 Lab. Rels.) ¶777.01 (Emphasis added) states that "not so well known is the fact that numerous long-term rental contracts, insurance policies, *long term bonds*, and other such contracts are geared to changes in the Consumer Price Index." Bachman, *supra* note 5, at 615 (Emphasis added) remarks that the "general increase in prices during World War II and the post-war years has led wage earners, pensioners, *bondholders* and others to seek refuge in various types of escalators." The only such instruments which this writer has been able to discover appear in the text *infra*.

<sup>15</sup> Other methods include hedging, which involves the use of a counter-balancing transaction; cost plus contracts; target or incentive contracts; delivery price contracts which provide that the price will be determined by market or cost conditions at the time of delivery. Cunningham, *The Use of Price Indexes in Escalator Contracts*, MONTHLY LABOR REV. 948 (1963). Also available from U.S. BUREAU OF LABOR STATISTICS, DEP'T OF LABOR, REPRINT No. 2424 (1963).

<sup>16</sup> Dawson & Coultrap, *supra* note 7, at 692-96.

<sup>17</sup> *Id.* at 690.

<sup>18</sup> Fisher had the Rand Kardex Company of Buffalo issue bonds containing an index clause, but they were recalled after several years when the Rand Kardex Company merged with another company and the index clause bonds were replaced by ordinary bonds. NUSSBAUM, *op. cit. supra* note 1, at 305. The bond provided that the obligor promises to pay to the holder "such sum of money as shall possess the present purchasing power of one thousand dollars (\$1,000) with interest thereon at the rate of seven per cent per annum, payable quarterly in such sums as shall, at the respective times

later instrument containing such a clause has recently been involved in federal tax litigation in the case of *Utility Trailer Mfg. Co. v. United States*.<sup>19</sup> The obligation there is in the form of a registered promissory note issued under permit from the California Corporations Commission, and is apparently patterned after an "inflation provision debenture" issued by Christiansen Corporation of Chicago, Illinois.<sup>20</sup> The debenture recites that,

since it is the purpose of the Company to pay to the holder of this Debenture at maturity, or any prior date of payment, and to pay interest on, an amount in dollars equivalent to the purchasing power of the Face Amount of June 15, 1952,<sup>21</sup> such payments of principal and interest shall be made in amounts which will provide for changes in the purchasing power of the Face Amount due to price changes as measured by changes in the "Consumer Price Index"<sup>22</sup>

There is a similar recital in the Utility Trailer Company note.

In both the Utility Trailer Company note and the Christiansen Corporation debenture, the obligor promises to pay a sum of money called the "Maturity Value," with interest payments to be computed on the "Prepayment Value." The actual consideration for the issue of the instrument is called the "Face Amount." The "Maturity Value" of these instruments is stipulated to be a minimum of 100% of the Face Amount.<sup>23</sup> It is to be computed by "multiplying the Face Amount by a factor obtained by dividing the Index Number for the year the instrument becomes due by the Base Index,"<sup>24</sup> such factor to be determined to the nearest one-hundredth.<sup>25</sup> The "Prepayment

of payment, equal in purchasing power one and seventy-five one-hundredths per cent (1.75%) of said purchasing power of one thousand dollars (\$1,000) all to be based upon an index number of the prices of commodities" The *Annalist*, Nov. 13, 1925, p. 603. The index employed was that of the U.S. Bureau of Labor Statistics for wholesale prices. *Id.* at 604.

<sup>19</sup> 212 F Supp. 773 (S.D. Cal. 1962).

<sup>20</sup> The opinion in the *Utility Trailer* case, *supra* note 19, at 778, states that the promissory note therein involved was based upon a similar debenture issued by a Chicago firm. The Christiansen debenture and the Utility Trailer note are almost identical in language.

<sup>21</sup> The date recited is the date of issue.

<sup>22</sup> Christiansen Plan—Inflation Provision Debenture, Chicago, Illinois, July 1, 1952. The applicable provisions of the instrument are reproduced in Appendix A.

<sup>23</sup> The Christiansen debenture provides that the maximum increase will be up to 150% of the face amount. The Utility instrument omits this provision, thereby leaving the door open to financial disaster in case of excessive inflation.

<sup>24</sup> The "Base Index" is the CPI number on the date of issue or on a stipulated date during the year of issue.

<sup>25</sup> Christiansen Plan—Inflation Provision Debenture, Chicago, Illinois, July 1, 1952, as reproduced in Appendix A.

Value" of the instrument, which is the measure for interest computation, is stipulated to be at least 100% of the Face Amount<sup>26</sup> and is to be determined annually in the same manner as the Maturity Value.<sup>27</sup>

The above discussion indicates the basic problem and the solution reached by some. The remainder of this paper will discuss specific problems raised by the use of index clauses.

### Gold Clauses and the 1933 Joint Resolution<sup>28</sup>

Prior to 1933, gold clauses were widely used as a means of protecting the obligee of a contract for the payment of money from depreciation in the value of currency. It is estimated that before 1933, gold

The instruments also provide for the mechanics of computation in the event that the Consumer Price Index is discontinued or there is a substantial change in the method of its compilation. This is an essential term because there would be no method of computation if a change were made in the absence of such a provision. The debenture provides that in the event a new index (also meaning a basic change in the present index) is promulgated by the Bureau of Labor Statistics (BLS), the BLS or its successor agency will be asked to supply a conversion table. The BLS finding shall be conclusive on both parties. If the CPI is discontinued, the Maturity Value and the Prepayment Value are to remain unchanged from and as of the last date that the CPI is published for the duration of the obligation. The Utility note also provides that the BLS shall be asked for a conversion table, but if it is not forthcoming, or the index is discontinued, a named third party shall determine the value of the obligation at the expense of the obligor. If the third party fails to determine the value, the amounts are to be frozen as above, on the last date the CPI is published.

<sup>26</sup> The Christiansen debenture provides that the maximum figure on which interest may be computed is 150% of the Face Amount. The Utility note omits this provision.

<sup>27</sup> See Appendix B for an example of the computations under this formula.

<sup>28</sup> Extensive literature about gold clauses and the Joint Resolution was written in the 1930's: Barry, *Gold*, 20 VA. L. REV. 263 (1934); Carpenter, *The Gold Clause Cases*, 8 SO. CAL. L. REV. 181 (1935); Collier, *Gold Contracts and Currency Regulation*, 23 CORNELL L.Q. 520 (1938); Collier, *Gold Contracts and Legislative Power*, 2 GEO. WASH. L. REV. 303 (1934); Dawson, *The Gold Clause Decisions*, 33 MICH. L. REV. 647 (1935); Dickinson, *The Gold Decisions*, 83 U. PA. L. REV. 715 (1935); Eder, *The Gold Clause Cases in the Light of History*, 23 GEO. L.J. 359 (1935); Glass, *Constitutional Validity of the "Gold Clause" Cases*, 7 MISS. L.J. 419 (1935); Hanna, *Federal Currency Restrictions and Gold Contracts*, 19 A.B.A.J. 349 (1933); Hanna, *Currency Control and Private Property*, 33 COLUM. L. REV. 617 (1933); Hart, *The Gold Clause in United States Bonds*, 48 HARV. L. REV. 1057 (1935); King, *The Gold Clause—Can it Constitutionally be Abrogated by Legislation?*, 2 GEO. WASH. L. REV. 131 (1934); MacLean, *Outline of the Gold Clause Cases*, 15 N.C.L. REV. 249 (1937); Nebolsine, *The Gold Clause in Private Contracts*, 42 YALE L.J. 1051 (1933); Nussbaum, *Comparative and International Aspects of American Gold Clause Abrogation*, 44 YALE L.J. 53 (1934); Payne, *The Gold Clause in Corporate Mortgages*, 20 A.B.A.J. 370 (1934); Post & Willard, *The Power of Congress to Nullify Gold Clauses*, 46 HARV. L. REV. 1225 (1933); Storke, *Monetary Legislation and the Gold Clause*, 6 ROCKY MT. L. REV. 237 (1934); Note, *Economic and Legal Aspects of the "Gold Clause" Dilemma*, 1 GEO. WASH. L. REV. 493 (1933); Note, *Effect of Gold Clauses Under Recent Legislation*, 29 ILL. L. REV. 655 (1935).

obligations in this country totalled more than one hundred billion dollars.<sup>29</sup> The typical American gold clause provided that the obligor would pay X dollars "in gold coin of the United States of . . . [or equal to] the standard of weight and fineness existing on . . . the date of contracting."<sup>30</sup> This clause was held to imply a secondary promise to pay the equivalent value in currency if gold coin became unavailable for payment.<sup>31</sup> Until 1933 these clauses were valid and fully enforceable. The clause was held not to render the instrument non-negotiable at common law,<sup>32</sup> or under the *Uniform Negotiable Instruments Law*.<sup>33</sup>

In 1933, the Seventy-Third Congress, by joint resolution, abrogated the use of gold clauses in domestic contracts.<sup>34</sup> Although there are no cases in point, commentators are unanimous in the view that the 1933 Joint Resolution should not be held to invalidate price-index clauses.<sup>35</sup> This conclusion is based upon two reasons: (1) the first sentence of the Resolution is patently inapplicable to an index clause

<sup>29</sup> NUSSBAUM, *MONEY IN THE LAW NATIONAL AND INTERNATIONAL* 226 (rev. ed. 1950).

<sup>30</sup> *Id.* at 229.

<sup>31</sup> *Norman v. Baltimore & O.R.R.*, 294 U.S. 240 (1934); *Feist v. Société Intercommunale Belge d'Electricité*, [1934] A.C. 161 (1933), reversing, [1933] 1 Ch. 684 (1933).

<sup>32</sup> *Eastman v. Sunset Park Land Co.*, 35 Cal. App. 628, 170 Pac. 642 (1917); *Chrysler v. Renois*, 43 N.Y. 209 (1870); *Wright v. Morgan*, 37 S.W. 627 (Tex. Civ. App. 1896).

<sup>33</sup> The UNIFORM NEGOTIABLE INSTRUMENTS LAW § 6(5) provides that the validity or negotiable character of an instrument is not affected by the fact "that it designates a particular kind of current money in which payment is to be made." Note, however, that a clause calling for payment in gold bullion would render an instrument non-negotiable because it was construed as calling for payment in a commodity. *Roberts v. Smith*, 58 Vt. 492, 4 Atl. 709 (1886); Nebolsine, *The Gold Clause in Private Contracts*, 42 YALE L.J. 1051, 1090 (1933).

<sup>34</sup> 48 Stat. 112 (1933), 31 U.S.C. § 463 (1958). The essential provisions are as follows: "(a) Every provision contained in or made with respect to any obligation which purports to give the obligee a right to require payment in gold or a particular kind of coin or currency, or in an amount in money of the United States measured thereby, is declared to be against public policy; and no such provision shall be made with respect to any obligation hereafter incurred. Every obligation, heretofore or hereafter incurred, whether or not any such provision is contained therein or made with respect thereto, shall be discharged upon payment, dollar for dollar, in any coin or currency which at the time of payment is legal tender for public and private debts (b) As used in this resolution, the term 'obligation' means an obligation payable in money of the United States; and the term 'coin or currency' means coin or currency of the United States."

<sup>35</sup> NUSSBAUM, *MONEY IN THE LAW NATIONAL AND INTERNATIONAL* 307 (rev. ed. 1950); Call, *Money and the Sliding Scale Clause in Contracts*, 24 Mo. L. Rev. 44 (1959); Dach, *Validity of Price-Index Clauses Under the Gold Coin Joint Resolution*, 13 GEO. WASH. L. REV. 328 (1945); Dawson, *The Gold Clause Decisions*, 33 MICH. L. REV. 647, 683 (1935); Dawson & Coultrap, *Contracting by Reference to Price Indices*, 33 MICH. L. REV. 685 (1935); Nussbaum, *Multiple Currency and Index Clauses*, 84 U. PA. L. REV. 569 (1936).

because an index clause is not predicated upon "gold or a particular kind of coin or currency" nor upon "an amount of money of the United States measured thereby";<sup>36</sup> and (2) the second sentence of the Resolution must be read in conjunction with the first sentence.<sup>37</sup> The wording of the second sentence of the Resolution is sufficient to invalidate a price-index clause if literally construed. It provides that "every obligation shall be discharged upon payment, dollar for dollar, in any coin or currency which at the time of payment is legal tender for public and private debts."<sup>38</sup> Under the nominal value theory of money, and construing the increase on an index clause obligation to be principal rather than interest, if the debtor is required to pay one hundred and fifty dollars to discharge an original indebtedness of one hundred dollars, the debt has not been discharged upon payment, "dollar for dollar." However, authority for construing the two sentences together is found in some of the better reasoned multiple currency cases<sup>39</sup> decided under the Resolution where clauses providing that the obligor pay X number of dollars in one of several alternative currencies have been upheld.<sup>40</sup> These courts have realized that the "dollar for dollar" language can "have but one meaning: if an obligation is payable in any particular kind of coin or currency, the debt may be discharged in any coin or currency that is legal tender."<sup>41</sup> If the latter construction is placed upon the Resolution an index clause would be valid because in the case of an index clause obligation there is no particular coin or currency that can be converted "dollar for dollar" into legal tender.<sup>42</sup>

The Supreme Court has indicated that the policy behind the 1933

<sup>36</sup> Dach, *supra* note 35, at 332; NUSSBAUM, MONEY IN THE LAW NATIONAL AND INTERNATIONAL 307 (rev. ed. 1950).

<sup>37</sup> Dach, *supra* note 35, at 332.

<sup>38</sup> 48 Stat. 112 (1933), 31 U.S.C. 493 (1958).

<sup>39</sup> Dach, *supra* note 35, at 331-36; Nussbaum, *Multiple Currency and Index Clauses*, 84 U. PA. L. REV. 569, 573-75 (1936). The following cases held that the Joint Resolution did not invalidate multiple currency clauses: *Anglo-Continental Treuhand, A.G. v. St. Louis So. W. Ry.*, 81 F.2d 11 (2d Cir.), *cert. denied*, 298 U.S. 655 (1936); *McAdoo v. Southern Pac. Ry.*, 10 F. Supp. 953 (N.D. Cal. 1935), *rev'd. on other grounds*, 82 F.2d 121 (9th Cir. 1936); *Zurich Gen. Acc. & Liab. Ins. Co. v. Bethlehem Steel Co.*, 279 N.Y. 495, 18 N.E.2d 673 (1939); *Lann v. United Steel Works Corp.*, 166 Misc. 465, 1 N.Y.S.2d 951 (1938). *Contra*, *Guaranty Trust Co. v. Henwood*, 98 F.2d 160 (8th Cir. 1938), *aff'd*, 307 U.S. 247 (1939); *Zurich Gen. Acc. & Liab. Ins. Co. v. Lackawanna Steel Co.*, 164 Misc. 498, 299 N.Y. Supp. 862, *aff'd sub nom. Zurich Gen. Acc. & Liab. Ins. Co. v. Bethlehem Steel Co.*, 254 App. Div. 839, 6 N.Y.S.2d 139 (1938); *Anglo-Continental Treuhand, A.G. v. Southern Pac. Ry.*, 165 Misc. 562, 299 N.Y. Supp. 859 (1936); *City Bank Farmers Trust Co. v. Bethlehem Steel Co.*, 244 App. Div. 634, 280 N.Y. Supp. 494 (1935).

<sup>40</sup> For example: I promise to pay to the order of B, X number of dollars in the United States in gold, or in England, in pounds sterling, or in Germany, in gold marks.

<sup>41</sup> Dach, *supra* note 35, at 332.

<sup>42</sup> *Id.* at 333.



Joint Resolution was to remove the depressing effect upon the economy caused by requiring a debtor to pay \$1.69 in currency upon a \$1.00 debt while still receiving taxes, rates, charges or prices at a basis of \$1.00 of that currency.<sup>43</sup> A debtor cannot easily afford to pay a debt at an increased amount when his income remains the same. Professor Dach believes that the use of index clauses is not violative of this policy because an index clause floats with the general level of prices, whereas the price of gold is arbitrary and does not necessarily reflect changes in the business or economic life of the debtor or creditor.<sup>44</sup> He states that neither creditor nor debtor can gain or lose as a result of such a clause because it merely eliminates the discrepancy between nominal and real value.<sup>45</sup> Professor Nussbaum disagrees in part, contending that such clauses do bear heavily upon the debtor by placing the whole burden of compensating for monetary depreciation upon his shoulders, although the burden may not be as great as under a gold clause because price indexes have a more direct relationship to the interests of the parties.<sup>46</sup>

There has been some indication that government policy is against the use of index clauses,<sup>47</sup> although the text of the statute and the records of the debates<sup>48</sup> and Committee Reports<sup>49</sup> in Congress indicate that only gold clauses were intended to be expressly affected. Moreover, index clauses have been in general use for various purposes since the passage of the Joint Resolution.<sup>50</sup> Still, doubts as to the effect of the Resolution upon index clauses must remain until some court has definitively spoken upon the question. It would also seem that there is more than the normal threat of new legislation to abro-

<sup>43</sup> *Norman v. Baltimore & O.R.R.*, 294 U.S. 240, 311-16 (1934).

<sup>44</sup> Dach, *supra* note 35, at 337-39.

<sup>45</sup> *Id.* at 337.

<sup>46</sup> NUSSBAUM, *MONEY IN THE LAW NATIONAL AND INTERNATIONAL* 306 (rev. ed. 1950). There is also some disagreement as to whether the use of index clauses is inflationary. Compare Johnson, *Are Cost-of-Living Escalator Clauses Inflationary?*, 11 *LAB. L.J.* 891 (1960), with NUSSBAUM, *supra* at 306 and Bachman, *Cost-of-Living Escalator Clauses—Here and Abroad*, 10 *LAB. L.J.* 615 (1959).

<sup>47</sup> The preamble to the Joint Resolution states that gold clauses are "inconsistent with the declared policy of the Congress to maintain at all times the equal power of every dollar, coined or issued by the United States, in the markets and in the payment of debts." 48 Stat. 112 (1933). See, Joint Committee on the Economic Report, *Monetary Policy and Management of the Public Debt*, S. Doc. No. 123, 82d Cong., 2d Sess. 142-45, 888, 1097-114 (1952).

<sup>48</sup> 77 CONG. REC. 4404, 4452, 4519-27, 4528-63, 4846, 4889-929, 5055, 5197 (1933).

<sup>49</sup> H.R. REP. NO. 169, 73d Cong., 1st Sess. (1933); S. REP. NO. 99, 73d Cong., 1st Sess. (1933).

<sup>50</sup> NUSSBAUM, *MONEY IN THE LAW NATIONAL AND INTERNATIONAL* 307 (rev. ed. 1950) points out that the United States itself used such a clause in an agreement with Cuba to purchase sugar in 1945.

gate such clauses if they mature into general use in debt obligations. Unless a maximum value provision were inserted in index clause obligations, heavy inflation would place a debtor in substantially the same position he would have been in under a gold clause before the remedial legislation abrogating its use.

### Negotiability Under Article 3 of the Uniform Commercial Code

Although gold clauses were held not to impair negotiability,<sup>51</sup> there has been general agreement by writers that the insertion of a price-index clause in an instrument otherwise negotiable would render the sum uncertain and the instrument non-negotiable under the law prior to the *Uniform Commercial Code*.<sup>52</sup> The negotiability of gold clause obligations was predicated upon a ground wholly inapplicable to index provisions. Section 6(5) of the *Uniform Negotiable Instruments Law* provided that the negotiable character of an instrument would not be affected by the designation of "a particular kind of current money in which payment is to be made." Gold clauses fell within this provision.<sup>53</sup>

The *Uniform Commercial Code* in section 3-104<sup>54</sup> contains the same basic requirement for a sum certain as did the *Uniform Negotiable Instruments Law*. Section 3-106<sup>55</sup> of the *Uniform Commercial Code* lists those provisions which will be held not to render the sum uncertain, and the wording of the comment to that section indicates that a price-index clause would render a promissory note non-negotiable within the *Code*. It states that in order for a sum certain to exist, the computation to determine it "must be one which can be

<sup>51</sup> Text at notes 30 and 31 *supra*.

<sup>52</sup> BRITTON, *BILLS AND NOTES* 81 (2d ed. 1961); NUSSBAUM, *MONEY IN THE LAW NATIONAL AND INTERNATIONAL* 308 (rev. ed. 1950); Call, *Money and the Sliding Scale Clause in Contracts*, 24 MO. L. REV. 44, 49 (1959); Dawson & Coultrap, *Contracting by Reference to Price Indices*, 33 MICH. L. REV. 685, 698 (1935); Nebolsine, *The Gold Clause in Private Contracts*, 42 YALE L.J. 1051, 1093 (1933); Nussbaum, *Multiple Currency and Index Clauses*, 84 U. PA. L. REV. 569, 594 (1936); Sims, *Currency and Sliding Scale Clauses in Contracts*, 15 ALA. LAW. 5, 17 (1954).

<sup>53</sup> NUSSBAUM, *MONEY IN THE LAW NATIONAL AND INTERNATIONAL* 252 (rev. ed. 1950).

<sup>54</sup> Section 3-104(1) provides: "Any writing to be a negotiable instrument within this Article must (b) contain an unconditional promise or order to pay a sum certain in money

<sup>55</sup> Section 3-106(1) provides: "The sum payable is a sum certain even though it is to be paid (a) with stated interest or by stated installments; or (b) with stated different rates of interest before and after default or a specified date; or (c) with a stated discount or addition if paid before or after the date fixed for payment; or (d) with exchange or less exchange, whether at a fixed rate or at the current rate; or (e) with costs of collection or an attorney's fee or both upon default."

made from the instrument itself without reference to any outside source<sup>56</sup>

Despite section 3-106, section 3-104 does make it possible for some writings to be made negotiable by other statutes or by judicial decisions.<sup>57</sup> Thus the door would be open for a new type of commercial paper which might develop in the future, such as price-index clause obligations. It would appear that there is little reason for an index clause to be held to affect negotiability by a court acting outside the scope of the *Code*. The requirements in form for negotiability are intended to protect the holder and insure transferability in the commercial market. The primary test should be whether or not a disputed provision in an otherwise negotiable instrument will derogate from the aggregate of rights which the holder is receiving.<sup>58</sup> If an index clause obligation contains a minimum face value provision<sup>59</sup> the holder will not have any risk of a reduction in the amount due; an index provision can only enhance the position of the holder.

The clearest analogy is to instruments payable in foreign currency. Such an instrument is declared by the *Code* to be a promise to pay a sum certain in money.<sup>60</sup> If the instrument does not otherwise specify, it may be satisfied by payment in the number of dollars that the foreign currency would purchase at the buying sight rate on the date of maturity or demand.<sup>61</sup> It will be noted that the actual amount due cannot be determined until maturity or demand, and even at that time cannot be determined from the face of the instrument. One writer states the policy behind this section as follows:

It is absolutely imperative of course, that a negotiable instrument be certain and definite as to amount payable, but this does not mean

<sup>56</sup> UNIFORM COMMERCIAL CODE § 3-106, comment 1. This comment appears to be aimed at interest provisions stated "at the current rate" but the policy would seem equally applicable to an index clause obligation.

<sup>57</sup> The language is, "to be a negotiable instrument within this Article." Comment 1 to § 3-104 states: "'within this Article' in subsection (1) leaves open the possibility that some writings may be made negotiable by other statutes or judicial decisions. The same is true as to any new type of paper which commercial practice may develop in the future."

<sup>58</sup> Compare *Citizens State Bank v. Pauly*, 152 Kan. 152, 102 P.2d 966 (1940), where the court stated that the "primary test to be applied in determining whether a disputed provision renders the amount that will be due on the note uncertain and therefore destroy [*sic*] negotiability, is whether the provision leaves a possibility of reduction in the amount collectible on the note. 'Certainty of amount' is not affected if the provision gives the maker no opportunity of reducing his note obligation." *Id.* at 157, 102 P.2d at 969.

<sup>59</sup> Both the *Utility Trailer* and *Christiansen* instruments provide that the principal obligation cannot drop below 100%.

<sup>60</sup> UNIFORM COMMERCIAL CODE § 3-107(2).

<sup>61</sup> *Ibid.*

that the purchase power of the instrument as of the date of its maturity must be ascertainable in advance. The purchase power of all money, foreign and domestic, is constantly varying, and one who exchanges property for money or the promise of money necessarily runs the risk that the future exchange value of the property will be less or greater than the future exchange value of the money.<sup>62</sup>

Although the nominal foreign sum on the face of such an instrument is certain, the amount of United States currency necessary to discharge the obligation will be uncertain until maturity. In both operation and effect, a provision for payment in foreign currency is very similar to a price-index clause. In both types of obligations the amount due is unascertainable until maturity, but is capable of ascertainment by reference to an extrinsic source at any given time during the term of the obligation.<sup>63</sup> Similarly, a foreign money clause could be used in certain situations to act exactly as does an index clause. Suppose, for example, there was a heavy inflation in the United States but not in Great Britain. If a United States citizen loaned money to a British citizen under such circumstances with the obligation being expressed in pounds sterling, the investment would be secure against depreciation in United States currency because the buying sight rate would reflect the changed economic situation. To this extent, the commercial certainty of an index clause obligation is no less than that of a foreign money obligation.

### Negotiability Under Article 8 of the Uniform Commercial Code

Article 8 of the *Uniform Commercial Code* deals with investment securities. Section 8-102(1)(a) provides that:

a security is an instrument which (i) is issued in bearer or registered form; and (ii) is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and (iii) is either one of a class or series or by its terms is divisible into a class or series of instruments; and (iv) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.<sup>64</sup>

<sup>62</sup> HAWKLAND, *COMMERCIAL PAPER* 12 (1959).

<sup>63</sup> It was the fact of ascertainability that led to judicial decisions upholding the negotiability of instruments providing for exchange. *E.g.*, *Whittle v. Fond du Lac Nat'l Bank*, 26 S.W. 1106 (Tex. Civ. App. 1894); DANIEL, *NEGOTIABLE INSTRUMENTS* § 54 (6th ed. Calvert 1913). The *UNIFORM NEGOTIABLE INSTRUMENTS LAW* § 2(4) and *UNIFORM COMMERCIAL CODE* § 3-106(1)d allow a negotiable instrument to contain a provision for exchange.

<sup>64</sup> This is declared by the comment to § 8-102 to be a functional definition of a

If an instrument fits within the above definition of a security, Article 3 of the *Code* will not apply.<sup>65</sup>

If properly drafted, either a price-index clause bond or promissory note<sup>66</sup> issued by a corporation could easily fit all of the requirements of Article 8 mentioned above except for (ii). The problem is in determining when an instrument becomes one "commonly dealt in." It is clear that the holder of a new type of instrument would not have Article 8 protection until enough time had elapsed for the instrument to become commonly recognized in investment circles.<sup>67</sup> Despite several broad generalizations as to the use of such clauses in corporation bonds,<sup>68</sup> this writer has been unable to uncover more than two such instruments in present use.<sup>69</sup> State,<sup>70</sup> and federal<sup>71</sup> agencies, as well as brokerage firms<sup>72</sup> and others,<sup>73</sup> have indicated that few of these instruments exist. It would appear that such instruments are either almost nonexistent, or are used solely in close corpora-

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security. It is so broad a definition that the New York Law Revision Commission has suggested that even theater tickets might technically fit within it. 3 1955 NEW YORK LAW REVISION COMMISSION REPORT 1889.

<sup>65</sup> UNIFORM COMMERCIAL CODE § 8-102(1)b.

<sup>66</sup> Promissory notes issued in a series are recognized as a medium of investment and if in bearer or registered form could come under Article 8 even though normally treated as commercial paper. 3 1955 NEW YORK LAW REVISION COMMISSION REPORT 1884.

<sup>67</sup> *Id.* at 1883.

<sup>68</sup> Note 14 *supra*.

<sup>69</sup> The two instruments are the Utility Trailer note and the Christiansen debenture, discussed *supra*.

<sup>70</sup> Although most state officials contacted indicated that they had no available information on such instruments, the following indicated that they had no recollection of an inflation provision instrument ever crossing their desks: Letter From N. J. Kiraly, Deputy Commissioner of Securities, Ohio, to the Author, Dec. 6, 1966; Letter From John F. Hueni, Corporation and Securities Bureau, Michigan, to the Author, Dec. 9, 1966; Letter From Truman G. Holladay, Deputy Commissioner, State Securities Board, Texas, to the Author, Dec. 7, 1966.

<sup>71</sup> Letter From George P. Michaely, Jr., Division of Corporation Finance, SEC, to the Author, Dec. 13, 1966, stating that records of recent filings do not show any such instruments. The only such instrument in Bureau of Labor Statistics files is the Christiansen debenture. Letter From Arnold E. Chase, U.S. Dep't of Labor, Bureau of Labor Statistics, to the Author, Dec. 19, 1966.

<sup>72</sup> The following stockbrokers and bondbrokers indicated that they had never seen such an instrument: Letter From William H. Hastings, Dean Witter & Co., New York, to the Author, Dec. 21, 1966; Letter From Edward N. Giobbe, Dempsey-Tegeler & Co., New York, to the Author, Dec. 22, 1966; Letter From Charles B. Kane, Mitchum, Jones & Templeton, San Francisco, to the Author, Dec. 14, 1966; Telephone Conversation With Thomas Uhry, E. F. Hutton & Co., San Francisco, Dec. 12, 1966.

<sup>73</sup> Mr. John E. Walker, Research Director for the Investment Bankers Association of America, states that the Association is "slightly familiar" with this type of financing in corporate and municipal bonds but is not aware of individual instances of such use. Letter From John E. Walker to the Author, Dec. 13, 1966.

tions for private issue. The anomaly is that until the instruments are in common usage they will not be negotiable, but until they are negotiable they are a poor investment. The *Code* does not define the terms "commonly dealt in" or "commonly recognized," so that the decision will be placed in the hands of the courts. If inflation continues, necessity may require that such clauses be inserted in bonds in order to make them more attractive to investors. The result of a sufficient issue of such instruments to make them "commonly dealt in" would be to accord them Article 8 protection.

### Tax Problems

There are two clear federal income tax problems raised by the use of index clause obligations. The first involves the status of bookkeeping adjustments for the increased "prepayment value" of the loan as accrued interest or discount expense under Internal Revenue Code of 1954, section 163(a). The second involves the taxability of the obligee for the amount received on retirement or sale of the obligation which represents the increase in the price-index during the term of the obligation.

Any accounting method<sup>74</sup> used by a corporation employing index clause obligations would indicate annual adjustments for changes in the actual value of the outstanding instruments. In *Utility Trailer Mfg. Co. v. United States*<sup>75</sup> the taxpayer contended that the book changes for each year on such an obligation constituted interest or discount expense under section 163(a)<sup>76</sup> and should therefore be deductible for income tax purposes. The court first held that the inflation provision notes constituted a debt obligation rather than a risk investment,<sup>77</sup> and that the alleged "cost-of-loan" expense would be deductible if accrued. But the court found that the payment of the increased amount was contingent upon a continued inflationary cycle which could reverse itself, and thereby eliminate the claimed expense.<sup>78</sup> Therefore the amount had not accrued and could not be deducted under section 163(a) <sup>79</sup> Thus the taxpayer was allowed to

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<sup>74</sup> There are cursory treatments of the accounting problems created by these bonds in Dawson & Coultrap, *supra* note 52, at 699; Nebolsine, *supra* note 52, at 1093.

<sup>75</sup> 212 F Supp. 773 (S.D. Cal. 1962).

<sup>76</sup> Section 163(a) provides: "There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness."

<sup>77</sup> 212 F Supp. at 791. This is important because there is no deduction allowed for amounts paid on capital or surplus invested in the business which do not represent charges arising under an interest-bearing obligation. Treas. Reg. § 1.163-1(c) (1966).

<sup>78</sup> 212 F Supp. at 793.

<sup>79</sup> *Ibid.*

deduct interest actually paid but was required to carry the increased obligation upon its books without a commensurate reduction in income tax liability

It also appears that the obligee of such an instrument would be taxed for the increased principal which he receives. The United States has successfully advanced the nominalistic theory of money<sup>80</sup> in a case where the taxpayer contended that purchasing power (value) is the proper measure for determining capital gains rather than the nominal amount. In *Bates v. United States*,<sup>81</sup> the taxpayer had purchased securities prior to the 1934 devaluation and sold them afterwards in a higher market. He objected to the assessment for capital gains on the ground that his nominal gain was financially nonexistent because of the devaluation of the dollar. The court ruled that purchasing power was irrelevant in a nominalistic system and held him liable for the tax, using the following language: "The standard unit of computation is the money dollar, an abstract or ideal unit of account. This standard unit of money has not changed in money value throughout the existence of our monetary system."<sup>82</sup> It would seem to follow that the holder of an index clause obligation could not resist the tax upon his nominal gain.

There is the further related question, however, of whether the Internal Revenue Service could classify the increased principal as straight income rather than a capital gain. Under section 1232 of the Internal Revenue Code of 1954, the part of the gain which represents an "original issue discount" will be taxed as ordinary income. An original issue discount is the difference between the "issue price" and the "stated redemption price at maturity."<sup>83</sup> The stated redemption price at maturity means the amount fixed by the last modification of the purchase agreement.<sup>84</sup> The issue price is the price paid by the first buyer of the obligation.<sup>85</sup>

It is apparent that the Utility Trailer and Christiansen obligations fall into an area left uncovered by the statute. If the changes wrought by an increased cost-of-living can be considered a "modification of the purchase agreement," then the last such change before maturity would give the stated redemption price at maturity. The issue price must be construed to be the actual consideration paid because of money nominalism. The difference between the two amounts would

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<sup>80</sup> Note 10 *supra*.

<sup>81</sup> 108 F.2d 407 (7th Cir. 1939), *cert. denied*, 309 U.S. 666 (1940).

<sup>82</sup> *Id.* at 408.

<sup>83</sup> INT. REV. CODE of 1954, § 1232(b)1.

<sup>84</sup> *Ibid.*

<sup>85</sup> INT. REV. CODE of 1954, § 1232(b)2.

be the original issue discount. The logical probability is that the increment would be considered capital appreciation and therefore eligible for capital gains treatment. Note, however, the anomalous position of the Internal Revenue Service in preparing for litigation against both the obligor and the obligee. In the former suit the taxpayer will contend that the increment is interest or discount expense under section 163(a) and should be deductible.<sup>86</sup> The obligee, however, must raise the opposite plea: that this is not discount expense under section 1232, but capital appreciation.

### Usury

In discussing index clause obligations with attorneys, the first question has invariably been, "What about usury?" The answer to this appears simple at first glance: the increment is not interest. The problem arises in reconciling the language of the cases with the terms of an index clause instrument. The contention of usury could be raised on two grounds: 1) that the increase in principal is interest; and 2) that the interest, as computed upon the increased value, exceeds the maximum allowable percentage of the face amount of the instrument. If the increment is held not to be interest, the second contention should also fail because the obligee is merely taking a legal percentage of actual principal.

It should first be noted that only a few states protect corporations from usury.<sup>87</sup> In the majority of states therefore, the question would not arise in regard to a corporate obligation.<sup>88</sup>

Usury is usually defined as the loan or forbearance of money payable absolutely at a charge in excess of the interest allowed by law.<sup>89</sup> A loan has been defined as a contract by which one delivers a sum of money to another, and the latter agrees to return at a future time an *equivalent sum* to that which he borrowed.<sup>90</sup> Interest is that which

<sup>86</sup> This contention was rejected in *Utility Trailer Mfg. Co. v. United States*, 212 F Supp. 773 (S.D. Cal. 1962).

<sup>87</sup> In California a corporation can plead usury as a defense to a contract. CAL. GEN. LAWS ANN. act 3757, § 3 (Deering 1954) (also printed as CAL. CIV. CODE § 1916-3). But see, *In the Matter of Washer*, 200 Cal. 598, 254 Pac. 951 (1927). In the following states a corporation may plead usury under certain statutory restrictions: Arizona, Florida, Kentucky, Michigan, New York, North Carolina, South Carolina, South Dakota. 1 P-H 1966 INSTALLMENT AND CONDITIONAL SALES ¶¶ 15, 911-61.

<sup>88</sup> Katz, *Usury Laws and the Corporate Exception*, 23 MD. L. REV. 51, 54 (1963) (lists jurisdictions which by statute exclude a corporation from defense of usury).

<sup>89</sup> E.g., *Allen v. Newton*, 219 Mo. App. 74, 266 S.W. 327 (1924).

<sup>90</sup> CAL. CIV. CODE § 1912; *Milana v. Credit Discount Co.*, 27 Cal. 2d 335, 339-40, 163 P.2d 869, 871 (1945); *Barnes v. Hartman*, 246 A.C.A. 266, 272, 54 Cal. Rptr. 514, 518 (1966).



is compensation for the use or forbearance of money which exceeds the sum loaned.<sup>91</sup> The problem arises in determining whether a "sum" is intrinsically nominal in its terms, or whether it can represent value. Clearly the increase is not a profit in terms of value.<sup>92</sup> Under a statute reading "any greater sum or any greater value for the loan or forbearance of money"<sup>93</sup> the increment would seem to be valid. The increased principal can only be considered compensation for a loan if the court applies the nominalistic theory of money.

There are several classes of usury cases which might be considered analogous to the index clause obligation. The first class involves the prediscount transaction. When the lender deducts an amount of money from the loan, so that the actual amount of money handed over to the borrower is less than that expressed on the face of the note, the transaction is *prima facie* usurious.<sup>94</sup> A court could construe an index clause obligation as falling within this class by holding that the difference between the amount loaned and that required to be repaid is a discount.

There is another group of cases which exempts from the operation of the usury statute, obligations which allow for contingent interest payments above the legal rate. If the payment of the full legal interest is subject to a contingency so that the lender's profit is wholly or partially put in hazard, the interest thus contingently payable need not be limited to the legal rate, provided that the parties are contracting in good faith and without the intent to evade the usury law.<sup>95</sup> This exception is tempered by the restriction that if the parties expect that the contingency will occur placing the total well over the maximum allowable interest, the intention to evade the usury

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<sup>91</sup> CAL. CIV. CODE § 1915 defines interest as "the compensation allowed by law or fixed by the parties for the use, or forbearance, or detention of money."

<sup>92</sup> RESTATEMENT, CONTRACTS § 527, at 1025 (1932) uses the term "profit" in discussing the exaction of interest, rather than the terms sum or value.

<sup>93</sup> CAL. GEN. LAWS ANN. act 3757, § 2 (Deering 1954) (also printed as CAL. CIV. CODE § 1916-2). CAL. CONST. art. XX, § 22 provides in part: "No person shall by charging any fee, bonus, commission, discount or other compensation receive from a borrower more than 10 percent per annum upon any loan or forbearance of any money, goods or things in action." Where the Constitution is inconsistent with the Usury Law, it supersedes it. CAL. CONST. art. XX, § 22. The term "any greater sum or any greater value" found in the Usury Law may be inconsistent with the Constitutional provision above. If so, the California courts could require nominalistic equivalence in repayment.

<sup>94</sup> *E.g.*, *Devers v. Greenwood*, 139 Cal. App. 2d 345, 293 P.2d 834 (1956); *Richlin v. Schleimer*, 120 Cal. App. 40, 7 P.2d 711 (1932); *Henning v. Akm*, 91 Cal. App. 246, 266 Pac. 981 (1928).

<sup>95</sup> *E.g.*, *Miley Petroleum Corp. v. Amerada Petroleum Corp.*, 18 Cal. App. 2d 182, 63 P.2d 1210 (1936).

law will be found despite the fact that such interest was subject to a contingency.<sup>96</sup>

There is a further exception to the usury law where the principal sum is subject to hazards and the repayment of the loan is subject in whole or in part to some contingency.<sup>97</sup> Thus, if an index clause instrument did not provide for a minimum maturity value of 100%, so that the principal sum would become subject to deflation, the usury law would not come into operation.

In the middle nineteenth century there were usury cases involving the loan of depreciated currency with a promise to make repayment in currency of a greater value with interest. The cases split on the issue of usury in this situation, most turning on the question of intent.<sup>98</sup> The cases are distinguishable from the present discussion because they involved the loan of one kind of money for repayment in another. Therefore, where the repayment was to be at par, the lender was not, as in the case of an index clause, preserving the value of the loan at the time made, but was extracting interest at a higher level than allowed by law. In one case the court held that where a party receives depreciated bank notes in payment and gives receipts for their nominal value, it is not a usurious transaction unless the real value of the banknotes exceeds the sum really due.<sup>99</sup> This case relied upon a comparison between the value loaned and the value to be repaid. An index clause would be valid under such a test because the value loaned and the value repaid are identical.

Finally, there were several cases involving gold clauses and usury contentions.<sup>100</sup> In one such case the borrower received \$4,000 in paper money and promised to repay \$4,000 in gold coin, or its equivalent value in current money at maturity.<sup>101</sup> The court held that this was not usurious per se, and affirmed a verdict for the obligee because of the absence of proof of usurious intent. This case could be good authority for either the plaintiff or defendant in a usury suit involving a price-index clause, depending upon whether or not usurious intent is proven.

<sup>96</sup> *Jameson v. Warren*, 91 Cal. App. 590, 267 Pac. 372 (1928); *cf.* RESTATEMENT, CONTRACTS § 527, comment a (1932).

<sup>97</sup> *Ambrose v. Alioto*, 65 Cal. App. 2d 365, 150 P.2d 502 (1944); RESTATEMENT, CONTRACTS § 527 (1932).

<sup>98</sup> *Bank of the United States v. Waggener*, 34 U.S. (9 Pet.) 378 (1835); *Helm v. Jessie*, 28 Ky. 428 (1831); *Burnham & Co. v. Gentrys*, 23 Ky. 354 (1828); *Caton v. Shaw*, 2 Har. & G. 13 (Md. 1827); *Pratt v. Adams*, 7 Page 615 (N.Y. 1839). *But see*, *Bank of the United States v. Owens*, 27 U.S. (2 Pet.) 527 (1829).

<sup>99</sup> *Helm v. Jessie*, *supra* note 98.

<sup>100</sup> *Stark v. Coffin*, 105 Mass. 328 (1870); *cf.* *Rhodes v. Fullenwider*, 25 N.C. 415 (1843).

<sup>101</sup> *Stark v. Coffin*, *supra* note 100.

### Conclusion

The most interesting thing about these clauses is the variety of questions which they raise and the anomalous treatment they may receive in litigation involving different issues, especially the question of whether the increment is capital or interest. These instruments could be very useful to an investor during an inflationary period. The main reasons for their lack of attractiveness to the investor have been unfamiliarity and lack of negotiability. Both of these problems are intricately interrelated; the instruments will be negotiable securities under Article 8 of the *Uniform Commercial Code* if they come into general usage. Practical problems of accounting and tax treatment remain to be solved. Protection against too great an increase in the obligation will have to be provided by the obligee. There will remain the possibility that the clauses may be struck down as usurious or as a violation of the public policy stated in the 1933 Joint Resolution. They are, however, a desirable innovation to protect the investor against inflation, and would be looked upon with favor by the public and by brokers adequately acquainted with their function. The problems involved could be solved by statute or judicial decision, if and when price-index clause obligations come into general use. The latter event may occur in view of the predicted continuation of the present inflationary spiral.

### Appendix A

No. R.

#### CHRISTIANSSEN CORPORATION

Christianssen Plan—Inflation Provision Debenture  
Due July 1, 1972

Chicago, Illinois  
July 1, 1952

§ 1.1. CHRISTIANSSEN CORPORATION, a Delaware corporation (hereinafter called "the Company"), for value received hereby promises to pay to the registered holder, on July 1, 1972, in such coin or currency of the United States of America as at the time of payment shall be legal tender for the payment of public and private debts, at its principal office in the City of Chicago and State of Illinois a sum of money (hereinafter called the "Maturity Value") the amount of which is to be determined in accordance with the provisions of section 1.2 of this Debenture, together with interest

from the date hereof payable to the registered holder of this Debenture at the said principal office of the Company on January 1 and July 1 of each year, such interest payments to be calculated at a rate of  $4\frac{1}{2}\%$  per annum on a sum of money (hereinafter called the "Prepayment Value") the amount of which is to be determined in accordance with the provisions of section 1.2 of this Debenture.

This Debenture is being issued in the sum of \$ (hereinafter called the "Face Amount").

§ 1.2. Since it is the purpose of the Company to pay to the holder of this Debenture at maturity, or any prior date of payment, and to pay interest on, an amount in dollars equivalent to the purchasing power of the Face Amount on June 15, 1952, such payments of principal and interest shall be made in amounts which will provide within the limits expressed below for changes in the purchasing power of the Face Amount due to price changes as measured by changes in the "Consumer's Price Index for Moderate Income Families in Large Cities-Combined Adjusted Series" (all Items), which index is now being published monthly in the "Monthly Labor Review" of the Bureau of Labor Statistics of the United States Department of Labor and is hereinafter referred to as the "BLS Consumers' Price Index" As used in this Debenture "Base Index" shall mean the index number for all items of the BLS Consumers' Price Index published by the aforesaid Bureau of Labor Statistics as the final official index number for June 15, 1952. "Index Number" shall mean the final official index number for all items of the BLS Consumers' Price Index as published at any specified date by the Bureau of Labor Statistics.

(a) The Maturity Value of this Debenture shall be at least 100% of the Face Amount and not more than 150% of the Face Amount. Within these limits the Maturity Value shall be determined by multiplying the Face Amount by a factor obtained by dividing the Index Number for January 15, 1972, by the Base Index, such factor to be determined to the nearest one-hundredth.

(b) The Prepayment Value of this Debenture shall be at least 100% of the Face Amount and not more than 150% of the Face Amount. Within these limits the Prepayment Value shall be determined semiannually as of January 15 and July 15 of each year by multiplying the Face Amount by a factor obtained by dividing the Index Number for January 15 and July 15 respectively by the Base Index, such factor to be determined to the nearest one-hundredth. The Prepayment Value as determined from the Index Number for January 15 of each year shall, for all purposes including, without limitation, the payment of interest, be considered the Prepayment Value of this Debenture from March 15 to and including September 14 of such year. The Prepayment Value as determined from the Index Number for July 15 of each year shall for all purposes, including, without limitation, the payment of interest, be considered the Prepayment Value of this Debenture from September 15 of such year to and including March 14 of the year succeeding such July 15.

(c) It is recognized that the base period of the BLS Consumers'

Price Index may be changed from time to time and that such changes may result in the publication of Index Numbers not directly comparable with the Base Index as defined above. In the event of any such change in the BLS Consumers' Price Index, Maturity Value and Prepayment Value shall be determined in accordance with the following provisions in order to utilize the Index Numbers which will be published:

(1) As used in this Debenture

(i) "New Index" means any index published regularly by the Bureau of Labor Statistics, its successor agency or other United States governmental organization which is designed to reflect changes in the cost of living to consumers due to price changes. In the event that more than one index is published by the Bureau of Labor Statistics, its successor agency or other United States governmental organization, which indices are designed to reflect changes in the cost of living to consumers due to price changes, the Bureau of Labor Statistics, its successor agency, or other United States governmental organization, shall be requested to certify to the Company which published index is most comprehensive in coverage and most nearly comparable with the BLS Consumers' Price Index. The index so certified shall be considered the "New Index" for purposes of this Debenture and such certification shall be final and binding on the Company and the registered holder of this Debenture. In the event that the Bureau of Labor Statistics, its successor agency, or other United States governmental organization refuses to certify to the Company which published index is most comprehensive in coverage and most nearly comparable with the BLS Consumers' Price Index, the Company and the registered holder of this Debenture agree that a third party shall be appointed by American National Bank and Trust Company of Chicago, a national banking association, now located at 33 North La Salle Street, Chicago, Illinois, who shall certify as to what published index is most comprehensive in coverage and most nearly comparable with the BLS Consumers' Price Index. The index so certified shall then be considered the "New Index" for purposes of this Debenture and such certification shall be final and binding on the Company and the registered holder of this Debenture.

(ii) "New Index Number" means any index number published by the Bureau of Labor Statistics or its successor agency or other United States governmental organization in the "New Index"

(iii) "Revised Base Index" means the number found in accordance with the provisions of this section 1.2(c) which will be comparable with the New Index Number.

(2) At the time the New Index becomes effective the Bureau of Labor Statistics, its successor agency, or other United States governmental organization publishing the New Index shall be requested to supply a conversion factor by means of which the Base Index may be redetermined on a basis comparable with the New Index Numbers. The finding of the Bureau of Labor Statistics, its successor agency, or other

United States governmental organization with respect to this conversion factor shall be final and binding upon the Company and the registered holder of this Debenture. The number obtained by applying the conversion factor to the Base Index (obtained to the nearest one-hundredth) shall be the Revised Base Index.

(3) In the event that the Bureau of Labor Statistics, its successor agency, or other United States governmental organization publishing the New Index is unable or refuses to supply a conversion factor, the Revised Base Index shall be determined by multiplying the Base Index by a factor obtained by dividing the New Index Number published for the last month that the old index number is official by the old index number for the last month in which the old index number is official. In the event that a New Index Number is not published for the last month in which the old index number is official, the Revised Base Index shall be determined by multiplying the Base Index by a factor obtained by dividing the New Index Number first published by the Bureau of Labor Statistics, its successor agency, or other United States governmental organization publishing the New Index by the last index number published by any of the aforesaid organizations prior to the change.

(4) Maturity Value and Prepayment Value will be determined as of the dates and as described in sections 1.2(a) and 1.2(b) substituting the Revised Base Index for the Base Index and the New Index Number for the Index Number.

(d) Changes in the name, methods of compilation, publication, or United States governmental agency directing the publication of the BLS Consumers' Price Index or any New Index as determined by section 1.2(c)(1)(i) other than changes in the base period or other changes herein provided for shall in no way affect the obligations of this Debenture or the methods of determining Prepayment Value and Maturity Value as described in this section 1.2.

(e) In the event that during the term of this Debenture the Bureau of Labor Statistics, its successor agency, or other United States governmental organization ceases to publish an index designed to reflect changes in the cost of living to consumers due to price changes, the Maturity Value and Prepayment Value of this Debenture shall be determined in accordance with the provisions of this section 1.2 for the last date of publication of BLS Consumers' Price Index or New Index. Such Maturity Value and Prepayment Value as determined of that date shall remain unchanged for the duration of the term of this Debenture.

## Appendix B

Suppose, for example, that X Corporation issues a ten year bond on January 1, 1967, for \$100.00 at six per cent per annum interest, and suppose that the Consumer Price Index on the applicable date is 90. If the interest computations were to be made as of December 1 of each year, the following chart might represent the transaction over a ten year period.

Issue Date: January 1, 1967  
 Face Amount: \$100.00  
 Base Index: 90  
 Maturity Date: January 1, 1977

Date	Current Index	Factor	Prepayment Value	Interest Due
12/1/68	100	$\frac{100}{90} = 1.11$	$1.11 \times \$100 = \$110$	\$6.60
12/1/69	105	$\frac{105}{90} = 1.17$	$1.17 \times 100 = 117$	7.02
12/1/70	108	$\frac{108}{90} = 1.20$	$1.20 \times 100 = 120$	7.20
12/1/71	107	$\frac{107}{90} = 1.18$	$1.18 \times 100 = 118$	7.08
12/1/72	113	$\frac{113}{90} = 1.25$	$1.25 \times 100 = 125$	7.50
12/1/73	115	$\frac{115}{90} = 1.28$	$1.28 \times 100 = 128$	7.68
12/1/74	120	$\frac{120}{90} = 1.33$	$1.33 \times 100 = 133$	7.98
12/1/75	128	$\frac{128}{90} = 1.42$	$1.42 \times 100 = 142$	8.52
12/1/76	135	$\frac{135}{90} = 1.50$	$1.50 \times 100 = 150$	9.00
12/1/77	140	$\frac{140}{90} = 1.55$	$1.55 \times 100 = 155$	9.30

The maturity value will be the same as the last prepayment value, \$155.00.